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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.,
Petitioner,

vs.

C. GORDON ANDERSON, TRUSTEE,
Respondent.

BRIEF FOR THE RESPONDENT

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Respondent.

BRIEF FOR THE RESPONDENT

This brief will respond to both the Brief for Petitioner and the Brief for the Securities and Exchange Commission.[1]

[1]Petitioner will sometimes be referred to as the stockholders committee and the Securities and Exchange Commission as the SEC.

STATUTES INVOLVED

The following sections of the Bankruptcy Act (11 U.S.C. 1 et seq.)[2] are involved in addition to those listed in the opposing briefs:

Section 27. *Compromises.* The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.

Section 209. Any creditor or stockholder may in a proceeding under this chapter act in person, by an attorney at law, or by duly authorized agent or committee.

Section 210. An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition.

Section 211. Every person or committee, representing more than twelve creditors or stockholders, and every indenture trustee, who appears in the proceeding shall file with the court a statement, under oath, which shall include—

* * * * * * *

(4) a showing of the claims or stock represented by such person or committee and the respective amounts thereof, with an averment that each holder of such claims or stock acquired them at least one year before the filing

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[2]Hereafter the references will be only to sections of the Bankruptcy Act and not to U.S.C. section numbers.

of the petition or with a showing of the times of acquisition thereof.

Section 216. A plan of reorganization under this chapter—

* * * * * * * *

(13) may include provisions for the settlement or adjustment of claims belonging to the debtor or to the estate; and shall provide, as to such claims not settled or adjusted in the plan, for their retention and enforcement by the trustee or, if the debtor has been continued in possession, by an examiner appointed for that purpose.

QUESTIONS PRESENTED.

Regarding the issues concerning the officers and directors of the reorganized company:

1. Whether the "law of the case" doctrine should be applied and the determination of these issues by the Fifth Circuit in 1964 recognized by this court without further consideration of their merits.

2. Whether the provisions in the plan of reorganization authorizing the reorganized company to employ the trustee and his subsequent employment by the directors of the reorganized company and election to its presidency are precluded by Chapter X of the Bankruptcy Act.

3. Whether after the plan of reorganization has been substantially consummated and the trustee and his management team have been employed to operate the reorganized company the employment of the trustee can be attacked without any efforts having been made to disqualify the trustee as such.

Regarding the issues with respect to the compromise of the Merrill-Stevens and Caplan mortgage claims:

4. Whether these claims were adequately investigated and whether the record discloses sufficient facts with respect to their basis and the objections to them to enable the district judge to render an informed decision on the compromises.

Regarding the issue concerning the insolvency of the debtor:

5. Whether there is substantial competent evidence to support the district court's finding of insolvency.

6. Whether the district court gave proper consideration to the future earning prospects of the debtor.

Regarding the issues concerning the alleged stockholder rescission claims:

7. Whether the claims were timely filed and filed in good faith by Petitioner.

8. Whether the facts in the record with regard to the issuance of stock by TMT indicate that stockholders who purchased their stock on the open market can properly assert rescission claims against the debtor and recover their losses from the debtor estate.

9. Whether rescission claims by stockholders of TMT would necessarily be subordinate to the claims of creditors.

Regarding the discharge of the stockholders committee:

10. Whether the discharge was proper since the debtor had been found insolvent.

STATEMENT OF THE CASE

The statement of the SEC, including its history of the proceedings, is accurate as far as it goes except for one sentence that is misleading. On page 8 of its brief, the SEC says: "Under the plan Merrill-Stevens, in conjunction with the trustee and his general manager, would have gained initial control of the reorganized company." This is misleading because there are seven directors of the reorganized company initially appointed by the court and, of course, any four of them constitute a majority and could "control" any decision that the directors are required to make. There is nothing in the record to suggest that the two persons from Merrill-Stevens together with the trustee and his general manager since their appointment have constituted a clique to run the reorganized company. Ultimate control is in the common creditors who have become the new stockholders and will hereafter elect directors of their own choosing.

The statement of the case in Petitioner's brief contains so many half truths and misleading and inaccurate statements that we are including our comments on them in an appendix at the end of this brief. It will suffice to recognize here that Petitioner's brief is replete with inflammatory verbiage and unnecessary innuendo which we will comment on further to the extent necessary in our argument.

This has been an unusual reorganization in several respects. The reorganization trustee has been highly successful in operating a business that during its brief existence prior to the beginning of the Chapter X proceedings had been wrecked by gross mismanagement. Claims

against the debtor totaled more than $5,400,000. (II 288)[3] When the trustee took over in November, 1947, the business was at a standstill, the three old World War II LSTs which it owned were in rundown condition needing repairs and no traffic was moving. (I 30) The success of the trusteeship enabled the court eventually to approve a plan of reorganization (III 260, 271) that provided for the payment in full of all preferred and secured claims[4] and turned the company over to its common creditors who exchanged their claims for the new common stock. The total face amount of these claims, after reclassifying the Merrill-Stevens lien claims as unsecured was in excess of $3,800,000. (II 288)

The unsecured creditors have been enthusiastic about this "internal" plan from the beginning and it is difficult to conceive of a more fair and equitable one. None of the cash offers for the assets of the debtor were ever seriously considered by any of the creditors because, as we will show under Point 4 c of our argument, these cash offers guaranteed little or nothing for the creditors while the internal plan gave them ownership of a business that had been successful under the trustee.

The internal plan, along with the compromises of the two largest lien claims that made the plan feasible, was originally proposed by the Creditors Committee representing unsecured creditors as a class (II 41-42) and was accepted in 1962 by these creditors over the cash plan by an 83.37% affirmative vote. (II 898) When the amended internal plan was sent out for approval in 1965 it was ac-

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[3]References to the record will be the same as the Petitioner uses, i.e. the records in the three appeals to the Fifth Circuit will be cited as "I", "II", and "III", respectively. (See Petition, n. 1, p. 2)

[4]Before the Merrill-Stevens and Caplan mortgage compromises these totaled more than $2,200,000. (II 288)

cepted by more than 95% of the unsecured creditors. (III 316) This increased acceptance of the plan after three more years of operation, not as successful financially as in 1961 and 1962 (discussed under Point 4 a below), reflects the confidence that all concerned had in the basic fairness of the plan and the conduct of the business by the trustee.

The statements of opposing counsel imply that the trustee has not pursued causes of action against persons responsible for the mismanagement of TMT before the reorganization proceedings began. The truth is, as everyone involved well knows, that two suits were brought to recover damages against many of the persons responsible. An action in the Southern District of Florida resulted in a final judgment against Eric Rath, the founder and "daddy" of TMT who was its president and dominated its activities. This judgment, in amount of $131,850.25 was entered October 16, 1963[5] and we have been unable to recover anything on it. The other case is pending in the Southern District of New York[6] and is against Joseph Abrams, Leo Levy, Irving M. Panzer, Robert M. Erdman, Whippany Center Corporation, and Joseph P. Day, Inc. It seeks to recover more than one million dollars in damages for fraudulent stock transactions and other irregularities arising out of the purchase by the debtor of property at Wilmington, Delaware. More than $13,000 has been spent by the debtor on fees and costs in this suit, which amount does not include expenses of the trustee and his counsel in connection therewith, but nothing has been recovered to date in that suit.

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[5]Case No. 11,267, *Anderson* v. *Rath*, in U.S. District Court for the Southern District of Florida.

[6]Case No. 61-Civ.-4639, *Anderson* v. *Abrams*.

SUMMARY OF ARGUMENT

1. The provisions in the plan of reorganization permitting employment of the trustee by the reorganized company are lawful and proper.

The decision of the Fifth Circuit on this issue in 1964 became "the law of the case" and should not be considered again in the current review of the plan since the provisions in the present plan on the subject are identical with those upheld in 1964 and the persons, including the trustee, approved in the former plan to initially operate the reorganized debtor are the same as those approved in the current amended plan. The Fifth Circuit has refused to reconsider its former decision on the subject and this court should refuse to disturb it because the trustee and the new management have taken over the operation of the business of the debtor and are operating it properly and without objection from the creditors (now new stockholders) concerned.

No provisions of law preclude the trustee from being employed by the reorganized company. The opposing contention that an interest in such employment necessarily as a matter of law means that the trustee has an interest adverse to the interests of creditors and stockholders cannot be sustained by proper construction of the statutes and in this case is contrary to the facts because it is obviously in the best interests of the reorganized company to retain the valuable services of the trustee and none of the creditors concerned have objected to this employment. The issue is one to be determined under the facts and circumstances of each case under Section 221(5) of the Bankruptcy Act and the decision here of the district judge and of the directors of the reorganized company should not be disturbed. The court of appeals has correctly upheld the

provisions in the plan on the ground that they do not assure the trustee of employment but merely put everyone on notice that he may be considered.

The opposing contention is based on interpretation of statutes relating to the *qualifications* of the *trustee* (Sections 156 and 158, Bankruptcy Act) and not on the provision governing the officers and directors of the reorganized company. (Section 221(5))

No effort has been made by anyone to disqualify the trustee during the many years that he has served while every plan of reorganization under consideration has contemplated his possible employment by the reorganized company. The present plan has been substantially consummated in fact and the effort to prevent the trustee from serving the reorganized company comes too late. The issue of his disqualification to serve as trustee should have been squarely presented years ago to the district court if the opposing contention is valid, and it should not now be held to vitiate the entire plan of reorganization.

2. The district court's approval of the directors of the reorganized company was lawful and proper.

The identity, qualifications and affiliations of the seven persons recommended by the creditors to be the officers and directors of the reorganized company were fully disclosed to the district court and their approval under Section 221(5) of the Bankruptcy Act is based on a record sufficient to satisfy the district judge that their appointment was in the best interests of the debtor. Neither Petitioner nor any other party has urged the appointment of any other persons.

3. The provisions in the plan of reorganization for the Merrill-Stevens and Caplan Mortgage claims were arrived at after intensive investigation and a prudent evaluation of the results and of the law, and reflect a fair adjustment of the equities.

Compromises of claims are normal and necessary in reorganization cases as this court has frequently held. They are expressly authorized by statute and should not be disturbed except upon a clear showing that the district court abused its discretion in approving them or acted arbitrarily. Objections to claims do not have to be heard or litigated where, as here, a compromise of the issues raised is included as an integral part of the plan of reorganization and extensive hearings are held on the fairness and equitableness of the plan.

The objections to the two claims were subject to intensive investigation by the trustee and his counsel, by the SEC, and by Petitioner. The results of these investigations were fully reported to the district court and the record contains an abundance of facts with respect to the claims and the objections thereto, sufficient to enable the court to render an informed decision on the merits of the compromises.

These claims asserted liens against the vessels of the debtor in excess of one milliion dollars and the litigation of the objections would have been expensive and time consuming, of highly uncertain outcome, and would have delayed unduly the preparation and processing of a plan of reorganization. The compromises were proposed by a Creditors Committee as a part of its "Internal" plan of reorganization and their approval was recommended strongly by experienced counsel for the trustee who had studied thoroughly the facts and issues involved and had

carefully weighed the probabilities of successful litigation over the objections.

The compromises satisfied lien claims of more than one million dollars for $250,000 with the remainder reduced in amount and exchanged for common stock in the reorganized company. This made the internal plan feasible and removed the last stumbling block to the prompt formulation of an acceptable plan. The unsecured creditors, the only real parties in interest, almost unanimously accepted the plan and none objected to the compromise of the two claims. The stockholders have no standing to object to the compromises because the debtor is insolvent and the compromises affect only the equity of the common creditors. If the two claims were to be disallowed *in toto* the debtor would still be insolvent. Dissenting stockholders of an insolvent company should not be permitted to impede a plan of reorganization desired by creditors unless they are willing and able to pay the costs of delay and extended litigation.

4. The district court's finding in insolvency was clearly correct and its determination of reorganization value was based on substantial and competent evidence.

Insolvency hearings were held before the district judge in 1962 and in 1965 when the plan of reorganization was under consideration. Extensive testimony was taken on the issue, including that of two expert witnesses who dealt with the future prospects of TMT. A complete record was made of the results of 7 years operation of the business by the trustee. There was an abundance of substantial and competent evidence to support the district court's finding of insolvency which was based on claims of more than $5,400,000 as against assets valued at less than $2,000,000 and a going concern value of $2,780,000.

The charge by opposing counsel that the district judge did not consider all relevant facts concerning future earning capacity is not sustained by the record. There is extensive testimony in the record by the trustee, his general manager, and the two experts on the subject. The district judge properly refused to require the trustee to make speculative estimates of future earnings based on operations after the acquisition of expensive new vessels requiring major new financing and possible changes in methods of operation, these being matters that could only be determined after reorganization by the new owners of the company. The evidence shows that the debtor has experienced a decline in earnings since the first finding of insolvency was made in 1962 and that any more recent estimate of going concern value would result in a figure less than the $2,780,000 finding made then.

Cash bids received by the district court for all the assets of the debtor do not indicate an erroneous finding of going concern value because these bids required the debtor to pay all the current liabilities of the trusteeship. Furthermore, they were decisively rejected by the creditors concerned.

5. Stockholders are not entitled to participate in the reorganized company on a parity with common creditors.

The reorganized proceedings have lasted ten years and no stockholder has filed any claim except counsel for the Petitioner. If the Stockholders Committee is supposed to represent stockholders having *claims* it is required by law to list the names of the claimants it represents and state the amount of the claims so the trustee and others interested can intelligently prepare a plan of reorganization. The unknown claims that Petitioner seeks to assert in a "class" claim are unliquidated in amount and arise out of

transactions on the open market to which the debtor was not a party. If there are any such claims, Petitioner should have filed them long ago and had ample time to do so after it became aware of facts upon which such claims might have been based. Instead, the Petitioner waited until *after* all the hearings had been held in 1962 for consideration of the fairness and feasibility of the plans under consideration to file the class claim and the one rescission claim of Mrs. Mason, one of Petitioner's attorneys. Up to that time, Petitioner had represented stockholders as such, and not as claimants, and the shifting of position can be explained only because it had become apparent that the debtor was insolvent and there would be no equity for stockholders. We therefore charge the Petitioner with not filing the alleged rescission claims in good faith and the district court properly refused to consider them for good cause as stated in its order. Petitioner wants the court to *invite* stockholders at this late date to file rescission claims and there is no provision of law authorizing such a procedure where such claims are grounded in tort, are unliquidated in amount, and each would be based on different facts and circumstances.

There are insufficient facts in the record to indicate that rescission claims against this debtor could lie. The facts in the record indicate to the contrary. There is no privity between such claimants and the debtor since the stock was purchased on the open market. The facts reported in the Trustee's Report of Investigation, which is quite complete on the subject, indicate that the debtor was the victim and not the perpetrator of the alleged fraudulent stock transactions which might give rise to rescission claims by open market purchasers of the stock. The securities acts and regulations thereunder remove the necessity for showing privity in rescission claims of this kind only to enable the guilty party to be reached. The guilty parties

are Abrams, et al. none of whom were officers or directors of TMT. The facts in the record are sufficient to sustain the district judge's finding that the alleged rescission claims were factually insufficient.

If rescission claims were allowed they would necessarily be subordinate to the claims of creditors. The set of facts disclosed by the record which caused the downfall of TMT, mismanagement connected with possible misrepresentation of assets and fraud in connection with issuance of stock, injured both creditors and stockholders, and where the assets are insufficient to satisfy both classes of claims, the latter must give way to the former under the strict priority rule of this court. The authorities sustain our position on this and the cases cited to the contrary by the SEC arising under the National Bank Act are not applicable because stockholders of national banks have unusual liabilities and are allowed priority status with creditors *by statute* under certain circumstances. The equities of the TMT situation require that defrauded stockholders be subordinate to defrauded creditors. Since the debtor is insolvent it would be useless to invite the filing of claims by stockholders.

6. The discharge of the stockholders committee was proper.

Since the debtor is insolvent and the plan of reorganization expressly provides that stockholders have no equity in the reorganized company, and the plan has been confirmed and largely consummated, there is no further need for the committee. The committee has been expressly authorized to prosecute appeals so no rights of stockholders have been prejudiced by discharge of the committee.

ARGUMENT

1. THE PROVISIONS IN THE PLAN OF REORGANIZATION PERMITTING EMPLOYMENT OF THE TRUSTEE BY THE REORGANIZED COMPANY ARE LAWFUL AND PROPER.

The success of the trustee in operating the business of the debtor made it almost inevitable that any group responsible for continuing the business after reorganization might want to retain the services of the trustee and the efficient management team that he had put together. His general manager, employed with the approval of the trial court, was B. E. Thouvenelle who had worked with the trustee for many years when they were in the retail merchandising business.

Counsel for the SEC stated in open court at the hearing in 1963 to consider consummation of the plan:

> There is no question that Mr. Anderson and Mr. Thouvenelle and their staff under the guidance of the court have done a wonderful and remarkable job in rehabilitating the debtor and operating it successfully. Mr. Anderson represents proven management and should be considered. (III 995)

Each plan of reorganization, as pointed out by opposing counsel, contained a provision authorizing the continuation of the trustee's services. Before the present internal plan was proposed and while interested parties were considering various proposals, the Creditors Committee appointed by the trial court to represent unsecured creditors as a class, filed a report on February 1, 1962, "to furnish information which the Creditors Committee believes will be of aid to any person desiring to submit a proposal for a Plan of Reorganization." (II 650) This report contained among other recommendations the following:

MANAGEMENT

> Of Course, if the payment to unsecured creditors is all in cash, management in the future would be unimportant to them. However, if any plan was submitted whereby it would be proposed that unsecured creditors take any portion of their claims in deferred payments or stock or securities of the reorganized company, the unsecured creditors would insist that as a part of the plant, that good and proper management be guaranteed. *This could include present management if such be proposed.* It is therefore suggested that if the proponents of any plan contemplate deferred payments or issue of stock or securities of the reorganized company to the unsecured creditors, that the plan specifically set forth the details about management. (Emphasis added) (II 652-653)

This Committee consisted of Harold Friedman and Paul G. Hyman, two attorneys with extensive experience in bankruptcy and reorganization matters and they have represented in these proceedings the interests of unsecured creditors as a class and particularly the mass of small creditors.

Thereafter, this Creditors Committee submitted on March 30, 1962, for consideration a Plan of Reorganization which was substantially the same as the Internal Plan now before this court. (II 41-42) They were the authors of the plan and *not* the trustee as implied in Petitioner's brief. Their plan stated that "It is necessary that competent management, which might include present management, be employed to operate the reorganized company . . ." and provided for certain shares of the new common stock to be reserved in connection with employment contracts with officers or management. It also provided that "The terms of any such contract which would be acceptable to present management if their services be

desired shall be requested and made available for inspection and discussion by the court and by any interested party at the time of the scheduled hearing on April 25, 1962." (II 41.11)

The purpose of the last quoted provision was to put everyone on notice that the creditors proposing the plan were considering the advantages of retaining the services of the trustee and his team and to meet the requirements of Section 221 (5) of the Bankruptcy Act that the identity and affiliations of persons who are to be directors or officers of the reorganized company be fully disclosed.

The plan as finally approved and confirmed contains this provision:

> f. The identity, qualifications and affiliations of the proposed initial officers of the reorganized corporation shall be reviewed by the Court prior to consummation of the Plan and the election of such persons to be such officers by the Directors will be subject to a determination by the Court under Section 221 (5) of Chapter X that their appointment to such offices is equitable, compatible with the interests of the creditors and stockholders of the reorganized corporation, and consistent with public policy.
>
> 7. It is necessary that competent management, which might include present management, be employed to operate the reorganized company and that any such management contract is to be approved by the new Board of Directors and the court. (III 257)

The district court order of July 11, 1962, approving the plan stated:

> The SEC memorandum also objected to the provision in the Internal Plan which contemplates that the reorganized company may employ the Trustee as its president. This provision, however, is not manda-

tory on the reorganized company and was inserted at the insistence of the court for the purpose of making full disclosure of what had come to the attention of the court. Both the Trustee and the creditors' committee had advised the court that certain of the largest unsecured creditors who favored an internal plan wanted the present management retained. There is nothing in the law which precludes a trustee from accepting employment from the reorganized company, and certainly the creditors concerned are entitled to insist on good management acceptable to them. (II 378)

Thereafter this plan was accepted by a large majority of the creditors[7] and the following were nominated by certain of the creditors for appointment as the initial seven man board of directors for the reorganized company: C. Gordon Anderson, B. E. Thouvenelle, Gardner T. Gillette, James C. Merrill, Jr., W. T. Coppedge, Jr., Shelby P. Langston, and Rafael Martinez-Alvarez. (II 978)

These directors were well known to the court and to all others concerned. Anderson and Thouvenelle were the trustee and his general manager; Gillette and Merrill were prominent Jacksonville businessmen who were affiliated with Merrill-Stevens; Coppedge was a Jacksonville businessman with Florida Towing Corporation, one of the major creditors; Langston was a leading Miami insurance agent and a creditor; and Martinez was the attorney for the debtor in Puerto Rico. (III 352-354) No others were suggested for consideration by the court except the attorney for one creditor whom the trustee presented to the court but who was satisfied with those named and agreed to their appointment. (III 355-356)

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[7]70.9% of the lien claimants and 83.37% of the unsecured claimants accepted the plan. (II 388 and 892)

The Order of Confirmation entered February 14, 1963, stated:

> 16. The identity, qualifications, and affiliations of the persons who are to be directors and officers and voting trustees, if any, upon the consummation of the said plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, will be equitable, compatible with the interests of the creditors and stockholders and consistent with public policy. (III 886)

It is apparent that it was known from the inception of the plan that the trustee and his manager were to be considered for employment and affiliation with the reorganized company, that the creditors concerned desired such affiliation and that there were no objections thereto from any real party in interest. All procedures required by law for proposing, identifying and selecting the initial directors of the reorganized company were carefully followed, especially those requiring notice and hearing.

The Fifth Circuit approved what had been done, holding that the trustee under the facts and circumstances here was not disqualified to serve the reorganized company and that his contemplated presidency of it did not vitiate the plan. *In re TMT Trailer Ferry, Inc.*, 334 F.2d 118 (1964).

The Fifth Circuit remanded the case only for further consideration of the feasibility of the plan, and thereafter the plan was amended only to provide for payment of the United States non-tax claims in full. There was no change made in the plan with respect to the management provisions and again in 1965 the same directors were proposed and approved by the district court after the amended plan had

gone through the prescribed procedure of approval, acceptance by the creditors, and confirmation.[8]

a. This issue was decided by the Fifth Circuit in the prior appeal and the decision should not be disturbed by this court under the "law of the case" doctrine.

As previously stated, this issue regarding the employment of the trustee was fully presented to the Fifth Circuit in the 1964 appeals involving the plan of reorganization and that court resolved the issue contrary to the contentions of Petitioner and the SEC. The affirmance of this part of the plan thereby became "the law of the case" and since it was not appealed to this court or otherwise changed the same decision should be permitted to stand.

When the plan came back to the district court in 1964 and was amended, it is significant that the SEC recognized that the issue had been settled. The SEC filed a lengthy report on the amended plan (III 215-242) but it made no comment on the subject except to note that the Fifth Circuit 1964 opinion "sustained the provisions in the Internal Plan with respect to the employment of the Trustee as president of the reorganized company." (III 223) Nor did the brief filed by the SEC in the appeal of the present plan to the Fifth Circuit discuss the issue of the employment of the trustee.

The district court's opinion and order approving the amended plan (III 260) did not discuss the issue *because it was not raised.* The record shows that when the matter was heard (III 351-357) the court asked twice (III 356)

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[8]See Opinion and Order Approving Amended Plan (III 260) and Order Confirming Internal Plan of Reorganization as Amended. (III 328) See also Order in Aid of Consummating Plan of Reorganization. (III 389)

if there were any comments or objections to the names of those proposed for appointment as the new directors of the reorganized company and there were none *even from counsel for the Stockholders Committee* who was present. The Trustee, of course, was one of the new directors.

The plan was taken by Petitioner back to the Fifth Circuit and that court mentioned in passing that Petitioner had again raised the issue "whether the plan should be rejected because the Trustee would become President of the reorganized company". Then the court said "The issue last stated was decided on that appeal in accordance with the decision of the district court," referring to its 1964 opinion. *Protective Committee* v. *Anderson*, 364 F.2d 936, 939 (1966).

It is apparent that all parties, except Petitioner here, including the district court and the appellate court considered that the 1964 opinion of the Fifth Circuit settled the issue.

> "This rule of 'the law of the case' is a salutary rule, necessary as a matter of policy in order to end litigation. It is based upon the ground that 'there would be no end to a suit if every obstinate litigant could, by repeated appeals compel a court to listen to criticisms on their opinions, or speculate of chances from changes in its members.'"
>
> *General American Life Ins. Co.* v. *Anderson*, 156 F.2d 615 (6th Cir. 1946).

> A decision of an appellate court in a given case is said to be "the law of that case" and no question decided therein will be decided in a subsequent appeal in that case unless there are compelling reasons presented for the court to reverse its prior position.
>
> *Ira Haupt & Co.* v. *Klebanow*, 348 F.2d 907 (2d Cir. 1965).

This court has said:

> In the absence of statute the phrase, "law of the case," as applied to the effect of previous orders on the later action of the court rendering them in the same case, merely expresses the practice of courts generally to refuse to reopen what has been decided, not a limit to their power.
>
> *Messinger* v. *Anderson*, 225 U.S. 436, 444.

The circumstances in this case clearly call for the application of the "law of the case" doctrine. The plan presently before this court is identical, insofar as the trustee's employment by the reorganized company is concerned, as the one approved in that respect by the 1964 decision of the appellate court. There is no compelling reason for overturning the decision three years later, but many reasons for allowing it to stand in this case. These reasons are:

1. The creditors concerned want to retain the valuable services of the trustee and his management team who have been highly successful in operating the business of the debtor.

2. The district court has approved what amounts to substantial consummation of the plan and has turned the operation of the business over to the new directors. Pursuant to Order in Aid of Consummating Plan of Reorganization entered May 25, 1965 (III 389-395), the trustee has issued nearly all the 1,300,000 shares of new common stock to the creditors entitled to it, the new directors have met and formally approved the $1,250,000 loan authorized in the plan and that loan has been consummated and its proceeds used to pay the creditors entitled to be paid in cash.[9]

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[9]Most of this money was used to pay in full the claims of the United States totaling approximately $1,097,000. (III 224)

The plan required *the reorganized company* to borrow this money (III 254) so it was necessary for the new directors to organize and execute the necessary loan documents. What is even more significant is that the new directors have taken over from the trustee responsibility for operating the business of the debtor, and all of the assets of the debtor have been transferred to the reorganized company. (III 340-344, 393-395) The new directors have employed the trustee and his general manager to operate the business at the same salary previously authorized by the court.

3. The best interests of the debtor require the continuation of the valuable services of the trustee. His success and capabilities have never been challenged and it would be detrimental to require the reorganized company to seek new and untried management. The best example of benefits derived from the trustee's success is that it has enabled all preferred and secured creditors to be paid *in full.* In the early years of the trusteeship the United States agreed to settle its non-tax claims of more than $900,000 for 27½% thereof in preferred stock of the reorganized debtor. (II 559-564) This was in 1959 but six years later the success of the business had been such that the government insisted on being paid in full in cash and this has been done.

The factors outlined above clearly show that the "law of the case" should be applied here and that there are no impelling circumstances requiring an exception to the rule. Control of the reorganized company has become vested in the management desired by the creditors concerned and to throw out this management at this late date would not be wise and could be disastrous to the company.

b. Chapter X of the Bankruptcy Act does not preclude the trustee from being employed by the reorganized company.

No court has held that the trustee may not be employed by the reorganized company. The Memorandum for the Securities and Exchange Commission filed by the Solicitor General in support of the petition herein (Case No. 952, October Term, 1966) lists in the footnote on page 9 other cases in which a Chapter X trustee has succeeded as president of the reorganized company.[10]

Congress specified in Section 158 of the Bankruptcy Act who shall be deemed a disinterested trustee and failed to state that an interest in employment by the debtor after reorganization is a disqualification. The SEC argues that if the trustee is being considered for future employment by the reorganized debtor, it necessarily and as a matter of law makes him a disinterested trustee.

This argument is not sound for it presumes that the trustee will breach the trust imposed in him. It engages in the assumption that as a matter of law a trustee who *intends* or *contemplates* that he will become president upon reorganization *necessarily* has an interest adverse to the interest of creditors and stockholders. This assumption belies human nature for a person with an incentive will do a better job than one marking time knowing there is no future for him. In any event, as the Fifth Circuit decision held, the TMT Trustee is not *assured* of future employment but his job depends entirely on the new directors.

Nor did Congress ever intend to make the test of "disinterest" dependent upon the subjective *intention* or *con-*

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[10]These cases are *In the Matter of F. L. Jacobs*, E.D. Mich., No. 42235; *In the Matter of Yuba Consolidated Industries*, N.D. Cal., No. 64103; and *In the Matter of Inland Gas Corp.*, E.D. Ky., No. 115.

templation of the trustee. The statutory tests in Section 158 of the Bankruptcy Act are all objective tests, and the SEC would write into the section words and meanings that are not there.

The argument of opposing counsel overlooks the benefits that the debtor might derive from being permitted to use the abilities of a successful trustee. It overlooks completely that fact that all actions of the trustee are subject to review and approval by the federal court, and the record in this highly contested proceeding indicates that all material decisions have been the subject of action by the court after hearing all interested parties.

Congress was given an opportunity in 1938 to write into Chapter X of the Bankruptcy Act a prohibition against a trustee or his attorney being employed by the reorganized company for a period of two years after substantial consummation but failed to act on the bill. This was emphasized on pages 11 and 12 of our Reply of Respondent to Memorandum for the Securities and Exchange Commission filed herein under date of May 16, 1967, and is admitted in footnote 30, page 31 of the SEC brief herein on the merits.

It is apparent that the SEC would have this court, in effect, add a provision to the law which Congress has not determined is necessary or desirable.

The Fifth Circuit placed the proper interpretation on the statute when it held that a trustee would not be disinterested unless "the proponents of a plan assured him of emoluments and security rather than merely nominating him for approval by the court and subject to the usual control of the Board of Directors." (334 F.2d at 119-120) There is no such assurance here as the plan clearly states.

c. There has been no attempt to disqualify the trustee because of his interest in employment by the reorganized company.

If the position urged by opposing counsel is correct, the trustee has been disqualified to serve for many years. The original plan of reorganization approved in 1959 was confirmed by an order expressly approving the trustee as president of the reorganized company. (II 517) We have previously shown that in the very inception of the present plan in 1962 the creditors who proposed it contemplated the employment of the "present management" including the trustee.

Nevertheless, there has been no motion to disqualify or remove the trustee, no motion to appoint an additional trustee, no effort made to refuse compensation to the trustee on the ground that he has a conflict of interest or violated his trust. Everyone has been content with the trustee's successful operation of the business.

It is too late *now* to urge that the *past* disqualification of the trustee precludes the reorganized company from employing him. The plan has been, in effect, substantially consummated, as previously shown. If the plan is otherwise valid, it would be inequitable to preclude the new owners of the company from using the valuable experience of the trustee.

Petitioner and the SEC are estopped now to prevent the employment of Mr. Anderson because they have failed throughout this proceeding to urge his replacement as trustee on the ground that he was disqualified to act. The statutes on which opposing counsel rely relate only to the qualification of the trustee as such and do not pertain to his right to be employed by the reorganized company. The latter is covered only by Section 221(5) of the Bankruptcy

Act which requires the court to confirm a plan if satisfied that "the identity, qualifications, and affiliations of the persons who are to be directors or officers . . . have been fully disclosed, and that the appointment of such persons . . . is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

The district court has made an affirmative finding under the above quoted section of the law (III 330) based on the facts and circumstances relating to this trustee. The court was never given an opportunity to test the *disqualification* of the trustee to act as such. It is too late now to raise the issue that he has been a disinterested and therefore disqualified trustee for many years.

2. THE DISTRICT COURT'S APPROVAL OF THE DIRECTORS OF THE REORGANIZED COMPANY WAS LAWFUL AND PROPER.

The SEC has made no attack on these directors, other than the trustee, either in this court or the lower courts.

Petitioner, however, with the invective which permeates its entire brief makes wholly unfounded charges against directors other than the trustee. We have previously identified these gentlemen and shown that their affiliations and qualifications were well known to the district judge and to all parties who were concerned with the proceedings, and that their selection was based on nomination of them by certain of the creditors. (II 978)

Pages 38 and 39 of Petitioner's brief contain insinuations that there was something improper in the activities of directors Coppedge and Langston buying the claims of others at a discount. The truth is that these transactions were all fully recorded and approved by the district judge without objection from anyone. The trustee and his attor-

ney were kept fully aware of them and the trustee called their existence to the attention of the court. (II 867)

Petitioner has not included in the record brought to this court all of the many petitions and orders entered approving the subordination of claim purchasers,[11] and it is improper to cast aspersions on these purchasers with no complete record here of the transactions as they are disclosed in the district court files.

Petitioner makes an unwarranted assumption in Point 1C, page 36 of its brief, that there are improper affiliations within the new management. Petitioner in the court below merely charged, in unsworn objections by counsel to approval of the plan, using vague generalities that there should be an "investigation" of "the Trustee's affiliations" with others interested in the debtor. (III 244-245) However, there was nothing to investigate as the material facts and circumstances were either spread upon the record or otherwise well known to the trustee, his counsel, the court, the Petitioner and all others who inquired.

The Fifth Circuit did not consider this issue worthy of discussion and there is certainly an insufficient record here to justify setting aside the district judge's approval of the new directors.

It is also significant to note that no party, including Petitioner, has suggested that any of the new directors be replaced, nor did Petitioner make any suggestion to the court as to who the directors should be.

Regarding that part of Petitioner's brief, page 38, which attacks the award of a towing contract to Florida Towing Company, it will suffice to say that this contract was the subject of several hearings before the district court

[11]Only 2 are in the record here. (II 667, 680, 754 and 755)

and several orders approving it[12] but *no appeal has been taken* in these proceedings from any of such orders. The orders pertain only to matters relating to the operation of the business of the debtor and not to the plan of reorganization. Petitioner's appeal which is the subject of this review is only from the order confirming the plan (III 340) and other orders unrelated to the operation of the business. (III 395 and 396)

We are confident that the court will recognize the impropriety of the numerous instances in which counsel for Petitioner has made shotgun charges of wrongdoing on the part of nearly everyone connected with the promulgation of the plan of reorganization.

3. THE PROVISIONS IN THE PLAN OF REORGANIZATION FOR THE MERRILL-STEVENS AND CAPLAN MORTGAGE CLAIMS WERE ARRIVED AT AFTER INTENSIVE INVESTIGATION AND A PRUDENT EVALUATION OF THE RESULTS AND OF THE LAW, AND REFLECT A FAIR ADJUSTMENT OF THE EQUITIES.

This court, speaking through Mr. Justice Douglas, has stated that the compromise and settlement of claims is not only an allowable procedure in reorganization cases, but is often a sensible and desirable course to pursue,[13] and that "compromises, settlements, and concessions are a normal part of the reorganization process".[14]

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[12]One of these orders is in the record here. (II 70)

[13]*Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106.

[14]*Institutional Investors* v. *Chicago, M. St. P. & P.*, 318 U.S. 523, 565.

The Bankruptcy Act Section 27, authorizing compromises of claims with the approval of the Court, applies to Chapter X, and such compromises may be effected separately during the proceeding, or in the body of the Reorganization Plan as expressly provided in Section 216(13).[15] *In re Associated Gas & Electric Co.*, 61 F. Supp. 11, aff'd 149 F.2d 996, cert. den. 326 U.S. 736; *Fernow* v. *Gubser et al.*, 136 F.2d 971 (10th Cir. 1943); *Collier on Bankruptcy*, Vol. 6A, par. 8.07, pp. 28-32; *Remington on Bankruptcy*, Vol. 2, Sec. 1155, pp. 634-645.

The approval of a compromise is an exercise of judicial discretion, which should not be disturbed unless the court acted arbitrarily or clearly abused its discretion. *Daniel Hamm Drayage Co.* v. *Willson*, (8th Cir. 1949) 178 F.2d 633, 635; *Fernow* v. *Gubser et al.*, supra; *In re Prudence Co.*, 98 F.2d 559 (2d Cir. 1938), cert. den., sub. nom. *Stein* v. *McGrath*, 306 U.S. 636; *In re Kalamazoo Bldg. Co.*, 21 F. Supp. 852 (1937).

It is clearly not required that the court litigate objections to claims (*In re Kalamazoo Building Co.*, supra), nor adjudicate the issues raised thereby (*In re Prudence Co.*, supra), before it may approve a compromise of such claims. The court need not evaluate the respective chances of success of the claimant or the trustee in connection with compromises. *In re Midland United Co.*, (D.C. Del. 1944) 58 F. Supp. 667, 681.

In the case of *In re Prudence Co.*, supra, the court after stating that the District Court did not determine the validity of the government's claim with respect to the taxability of the "commissions" and "nor need this court do

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[15]General Order 33, cited by Petitioner (Brief p. 32), is not applicable where the compromise and settlement of claims is embodied in the Plan of Reorganization. Collier, *Bankruptcy* (14th Ed.), par. 8.07, Vol. 6A, pages 31-32.

so", said "The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, . . ." (98 F.2d at 560).

To the same effect is *Florida Trailer & Equipment Co.* v. *Wiley R. Deal,* 284 F.2d 567 (5th Cir. 1960).

It is important to note that *no creditor* has objected to the provisions in the reorganization plan for the compromise of these two claims. That is true both in the two appeals to the Fifth Circuit and in the proceedings here. There were numerous hearings prior to the approval of the plan and its confirmation both in 1962 and in 1965 but at none of them did any creditor voice or file any objection to the Merrill-Stevens or Caplan settlement provisions. We have previously pointed out that the creditors accepted the plan by overwhelming vote in 1962 and in 1965.

The unsecured creditors were the parties benefited by the settlements. The Caplan preferred ship mortgage claim was reduced in amount and the Merrill-Stevens maritime lien claims of $574,000 were reduced to unsecured status. The equity of the unsecured creditors was thus materially increased and an early plan of reorganization made possible. Likewise, it was the unsecured creditors who stood to gain if the claims could be materially reduced by litigating the objections to them. They were the real parties in interest—not the stockholders since the debtor was insolvent.

The brief for the SEC (p. 40, footnote 37) urges that the Fifth Circuit decision on review here erroneously attached significance to the fact that the creditors had not complained of the compromises, citing as authority *Case* v. *Los Angeles Lumber Products Co., Ltd.,* 308 U.S. 106, 114. That case is not in point because it involved settle-

ment in the plan of reorganization of a claim by stockholders that they were entitled to an equity in the reorganized company. This court held in *Case* that the strict priority rule precluded stockholders from being given any such equity where the debtor was clearly insolvent even though a big majority of the creditors approved cutting in the stockholders for a small slice of the equity, and that even a creditor who was among the small minority that did not approve the plan could have it set aside as not being fair and equitable to him.

The situation with TMT is quite different. The two compromises affect only one class—the unsecured creditors—and their acceptance of it is a material factor to consider as against the objections of an inferior class, the stockholders.

The compromises were first proposed as an integral part of the internal plan of reorganization submitted by the Creditors Committee. (II 41.5-41.6) These compromises eliminated the two largest lien claims against the vessels of the debtor.

The basis of the arguments by the SEC against the approval of the compromises is that "The record contains no evidence, upon which the merits of these claims could be evaluated, or upon which the district court could have made the 'informed, independent judgment' . . . which is necessary for approval. . . ."[16] In addition, the Petitioner claims that there was inadequate *investigation* of the facts with respect to the claims and the objections thereto. Neither of these contentions can be sustained by the record.

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[16]SEC brief, pp. 36-37.

The Merrill-Stevens Claim

The record contains an abundance of pleadings and allegations concerning the facts with respect to the Merrill-Stevens claim. These facts are stated in sufficient detail to enable the trial court to render an informed decision on the merits of the compromise of the claim. The facts with respect to the claim are in the following portions of the record:

(1) Proof of Claim filed on April 1, 1958, by Merrill-Stevens. (Not printed in the record but outlined at II 22-23)

(2) Facts asserted in letter dated Nov. 10, 1958, from counsel for the Stockholders Committee to Judge Choate with respect to defects in the work done on the Carib Queen. (I 130)

(3) Facts outlined in the trustee's Report of Investigation filed July 1, 1960, with respect to the construction and breakdown of the Carib Queen. (I 270-271)[17]

(4) Objections of the SEC to the claims of Merrill-Stevens and Shaffer-Spitzer, filed January 20, 1961. (Not in the record here but referred to in the index, II 2)

(5) Specifications in Support of the objection of the SEC to the Merrill-Stevens claim, filed September 1, 1961. (II 405-411) This was based on an investigation by the SEC of the Merrill-Stevens claim.

(6) Answer of Merrill-Stevens to the above Specifications of the SEC, filed September 1, 1961. (II 1098-1101)

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[17]This motion states that the trustee had agreed to settle the Merrill-Stevens claim in 1959 "following an examination of the debtor's records which indicated that work had been performed on the vessels as indicated in the claim". (II 23-24)

(7) Motion for Allowance of Claim, filed by counsel for the trustee on December 31, 1961. (II 22-26)[18]

(8) Objections of the United States to the above motion, filed January 18, 1962. (II 647-649)

(9) Hearing in open court on the above motion, January 23, 1961. (II 35-40)

(10) Specification of Objections to the Claim of Merrill-Stevens, filed by the Stockholders Committee on February 12, 1962. (II 1042-1072.4) This was based on the Stockholders Committee investigation of the claim.

(11) Statement of the SEC in Support of Stockholders Committee Contentions re Merrill-Stevens Claim, filed February 16, 1962. (II 1073-1074)

In addition to the facts detailed in the documents listed above, the trustee and his counsel had available and examined numerous documents assembled by the SEC during its investigation of the claim and they also examined statements made by individuals and numerous documents furnished by Merrill-Stevens. None of this data is shown in the record, but the examination of it was reported to the court by the trustee and his counsel. (II 25)

The documents listed above show that there were at least four investigations of the Merrill-Stevens claim: (1) the trustee's investigation in 1959 with respect to the work performed on the vessels, (2) the SEC investigation in 1961, (3) the investigation made by counsel for the trustee in 1961 based on documents from the SEC investigation and

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[18]Additional facts developed in testimony taken during the investigation were filed with the trial court but are not in the record here.

others received from Merill-Stevens, and (4) the Stockholders Committee investigation of 1962.

While all of the documents examined and persons interviewed in these investigations are not shown in the record, the results thereof were reported to the court as outlined above and are shown in the record. Of particular benefit were the very thorough investigations made by the SEC and the Stockholders Committee which are reported in great detail. (II 405-411 and 1042-1072.4) In addition to the facts reported in these investigations, the district court was influenced by the impartial and objective analysis made of the claim and the objections thereto by counsel for the trustee (II 22-26) who advised the court "that the possibility is remote of obtaining any reduction, or material reduction, in the amount of the Merrill-Stevens claim by litigating the objections filed against it" (II 25-26) and that "a fight of the issues would be time-consuming and expensive to the estate and would result in unnecessary delay in forming a Plan of Reorganization." (II 35)[19]

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[19]As an example of the type of information which the trustee's counsel examined during his investigation, which does not appear of record, was the written report submitted by the SEC of an examination of Coast Guard records pertaining to the Carib Queen breakdown made by a Navy chemical engineer, Edward Wagman, which includes these conclusions:

d. The ship's crew on each incident of failure and prior thereto appears to have been either wholly responsible or at least culpable to a great extent.

e. The responsibility of Merrill-Stevens for the casualties which occurred after January, 1957, is beyond a reasonable and fair appraisal of the facts at hand.

f. The possibility of attributing the cause of the first casualty to Merrill-Stevens exists and although there is a closer causal-connection to it than to subsequent casualties, it is a rather flimsy connection and the probabilities have to be stretched beyond their likelihood.

Without detailing the issues with respect to the objections to the claim as these are thoroughly aired in the opposing briefs, it will suffice to point out it is undisputed that Merrill-Stevens did extensive work on the vessels of the debtor for which it has not been paid and that all the issues concerned its *tort liability* for the results of its work and whether some of the work done could properly give rise to maritime liens against the vessels. The compromise released lien claims against 5 of the vessels totaling $574,580.35 (II 41.6) and provided for payment of these claims only in common stock of the reorganized company. Thus, the largest lien claims against the vessels were satisfied without using any of the cash needed to insure the feasibility of the plan.

The Caplan Mortgage Claim

The facts and circumstances with respect to this claim are thoroughly documented in the Trustee's Report of Investigation. (II 579-617) Most of the investigation concerned the Caplan mortgage and, as stated in the footnote on page 44 of the SEC brief, the investigation covered 14 days of hearings, testimony of 33 persons covering 2200 pages, and more than 60 exhibits.

The district court had before it for consideration in connection with the proposed compromise the Trustee's Report of Investigation, a lengthy answer of Shaffer-Spitzer, Trustees, to the report of investigation (I 298-304), the several objections filed to the claim, the claim itself, and the recommendations of the Creditors Committee, the trustee and trustee's counsel favoring the settlement. These are all in the record here, but in addition the district court had the full record of the trustee's investigation, which is not in the record brought to this court.

Trustee's counsel recommended approval of the Caplan settlement for substantially the same reasons as for the Merrill-Stevens settlement, namely that the settlement was a reasonable one under the circumstances, that litigation of the objections was uncertain and would be costly and would unduly delay reorganization. (II 661-662)

Regarding the merits of the claim, the trustee's investigation report discloses that the debtor on May 31, 1957 executed and delivered to Caplan, as trustee, and there were promptly recorded, two first preferred ship mortgages on three unencumbered barges and on the ship "Cuba" in the face amount of $330,000, payable January 1, 1957 without interest, and in the event of default with interest at the rate of 6% and all legal expenses, and convertible into common stock at the option of the holder on the basis of one share for each $1.25 principal amount. The sum of $280,500 in fresh capital was paid for the mortgages, and an additional $49,500 was paid for 49,500 shares of common stock. The total sum of $330,000, which was so paid by the participants in the Caplan group, was disbursed primarily to meet an installment due on a mortgage on a different vessel (the Carib Queen), to satisfy a mortgage, libels, and claims against two of the vessels mortgaged to Caplan, and to pay recording fees, and the balance was utilized by the debtor for working capital. (II 599-600)

If valid and enforceable according to its terms, Shaffer-Spitzer, trustees, would be entitled to be paid in cash the aggregate of $330,000, plus 6% interest for over 6 years or in excess of the additional sum of $120,000, plus legal fees and disbursements in a presently undetermined but substantial amount. By the time of consummation, the cash outlay would materially exceed $500,000, or would involve a substantial cash outlay plus delivery of assets vital to the debtor and its business.

In contrast, the plan of reorganization provides for payment of $250,000; the past due interest on $280,500 from January 3, 1958 is to be allowed, but only as an unsecured claim. (II 693-694)

It will be noted that (a) the principal amount of the claim is reduced by $80,000; (b) no legal fees are payable to or for the attorneys for the creditor, nor is it reimbursed for any part of its very substantial expenses incurred in this proceeding; (c) the accrued interest, instead of receiving priority treatment along with the principal is subordinated to the status of an unsecured claim; (d) unlike other holders of maritime liens, the Caplan mortgage holders are not afforded the privilege of converting the principal amount of their claim into new stock of the reorganization debtor, except that with respect to past due interest it will receive stock on a parity with unsecured creditors, which will amount to a miniscule percentage of the total participating claims (II 288); and (e) the holders of the Caplan mortgages will have no representation on the board of directors (II 987) and no meaningful say in the affairs of the reorganized debtor other than that of a small minority stockholder.

The District Court's Findings

It is readily apparent that the district court had before it a thorough record concerning the facts and issues with respect to the compromises of these two claims. The order of the court approving the plan of reorganization discloses that its decision to accept the settlements was the result of a prudent evaluation of the law and of the facts and circumstances involved. The court said in its 1962 order:

> While the vessel valuation proceedings were in progress and before any of the lien adjudication and

marshalling proceedings had begun, the trustee and the unsecured creditors committee appointed by the court to represent that class of creditors were given informal permission by the court to contact the principal lien and priority claimants for the purpose of attempting to compromise and settle the issue involving such claims. This was deemed wise because it was apparent that the liquidation of the issues involved, particularly the objections to the Caplan and Merrill-Stevens claims, would take possibly years to conclude and it was the opinion of the court as well as the trustee and the creditors committee that the financial success of the trusteeship required the early reorganization of the debtor if at all possible.

Negotiations by the trustee and the creditors committee resulted in proposed compromises of the Caplan mortgage claim and the Merrill-Stevens claims, which compromises are included in the Internal Plan of Reorganization, initially filed by the creditors committee. It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders Committee is too remote for serious consideration. If the unsecured creditors approve the Internal Plan with these compromises, the only class that can object are the stockholders, and the court has found in the Valuation and Insolvency Order that the stockholders have no equity even if these two claims were disallowed in toto. The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act. (II 372-373)

Three years later Petitioner asserted that it had uncovered more facts concerning the Merrill-Stevens claim (III 16-20) and the material allegations with respect to them were denied under oath by Merrill-Stevens. (III 69-70) A hearing was held on the matter (III 83-88) during which counsel for the trustee advised the court that the further "witch hunt" by the Petitioner had not shown any good cause for further consideration of the settlement. The court agreed and rejected the effort to reopen the matter (III 73-74) and after several further hearings on the amended plan (III 21-65, 100-112, 120-212) the court approved the amended plan with the two compromises in it (III 250-252) and again overruled the objections to the compromises. (III 263-264)

It is important to note the district court found (III 373) that if the Merrill-Stevens and Caplan mortgage claims were *disallowed in toto* the debtor would remain insolvent and the stockholders would still have no equity. This finding is clearly supported by the evidence as we will show under the next point.

Dissenting stockholders of an insolvent company should not be permitted to impede Reorganization by insisting upon costly and protracted litigation of claims unless they will bear the costs thereof. *In re John H. Woodbury Dermatological Institute,* 191 Fed. 819 (2d Cir. 1911); *In re Ben L. Berwald Shoe Co.,* (N.D. Tex.) 1 F.2d 494 (rev'd on other grounds 10 F.2d 275, cert. den. 271 U.S. 671). Nowhere in the record do the stockholders propose to bear such costs but on the contrary insist that the debtor do so, necessarily at the expense of the equity of the creditors.

It would be highly inequitable to permit the stockholders to delay the final consummation of the plan of reorganization while the trustee gambles on the outcome of

time consuming and expensive litigation over these claims. The provisions in the plan for these claims should therefore be upheld.

4. THE DISTRICT COURT'S FINDING OF INSOLVENCY WAS CLEARLY CORRECT AND ITS DETERMINATION OF REORGANIZATION VALUE BASED ON SUBSTANTIAL AND COMPETENT EVIDENCE.

The issue is whether or not the debtor is insolvent and not whether the lower court accurately computed its going concern value. A precise finding of value is not necessary to eliminate the stockholders. *Institutional Investors* v. *Chicago, M. St. P. & P.*, 318 U.S. 523, 539.

An estimate of going concern value, as distinguished from mathematical certitude, is all that can be made. *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 512, 526.

On appellate review, this issue is whether the finding of insolvency by the trial court is *clearly erroneous*, and whether there was substantial and adequate support in the evidence for the finding. *Spitzer* v. *Stichman*, 278 F.2d 402, 410 (2d Cir. 1960). *Trinity Building Corp. Pref. Stockholders* v. *O'Connell*, 155 F.2d 327, 329 (2d Cir. 1946). Great credence is to be given to the reorganization judge's long familiarity with the debtor and his evaluation of the witnesses. *Meyer* v. *Dolan*, 145 F.2d 880, 881-882 (2d Cir. 1944). The appellate court should not try to resolve disputed evidence on this subject. *Trinity Building Corp. Pref. Stockholders* v. *O'Connell*, supra.

a. There is an abundance of competent evidence to support the district court's findings of insolvency.

The first valuation hearings were held before the district judge in the early part of 1962 when the plans of reorganization proposed at that time were being considered. They consumed several days, with many witnesses and numerous exhibits. (II 42-310, 310.52-356)

The book value of the debtor's assets as of May 31, 1962, was shown to be $1,887,185.77 (II 387.1-387.2) as against claims arising prior to the reorganization proceedings of $5,477,370.05. (II 288)

The trustee first presented evidence as to the actual fair value of the debtor's assets, as distinguished from their book value as shown above. A special master had taken evidence and reported on the value of the vessels (II 10-22) and other evidence was received during the valuation proceedings as to the actual or fair value of the remaining assets. (II 45-50, 221, 222, 223) The result of this evidence was to raise the value of the assets to $2,238,387.62 and to increase the net value of the debtor's assets to $1,978,481.73 and the court so found in its order. (II 387.2)

This net appraised value of the debtor's assets is material because it is *lower* than the going concern value of the trustee ($2,031,000) and of the court ($2,780,000). The significance is that we have a business dependent for its value not on the inherent value of its assets but primarily on maintaining a high level of earnings. It is necessary, therefore, that its future earnings be estimated as accurately as possible based on present use of the existing assets and that consideration be given to unfavorable as well as favorable economic factors in the future.

As a basis for estimating future earnings to determine going concern value the trustee presented a series of ex-

hibits which included all balance sheets and earnings statements from the beginning of the trusteeship through May 31, 1962 (II 198-220, 355, 356), statements showing the historical build up of the book value including trustee's costs of additions covering all tangible assets (II 221-222), an analysis of the vessel valuation evidence (II 223), projections of estimated income, expenses and earnings for future years through 1965. (II 224-226, 350-354) Other exhibits not directly material to the valuation issues were introduced to show the effect of and the feasibility of the internal plan of reorganization. (II 288-299, 348, 349) These exhibits gave the court and interested parties *all material information available from the records of the debtor* with respect to its assets, liabilities and earnings from the beginning of the trusteeship through May 31, 1962.

The trustee analyzed the evidence and computed a going concern value of $2,031,403.72. (II 227-229)[20]

The trustee presented a valuation expert, Dr. William G. Heuson, Professor of Finance at the University of Miami, who took the trustee's estimates of future earnings and computed the going concern value at $1,607,692. (II 125) He admitted on cross-examination that his value could go as high as $1,800,000. (II 160) Dr. Heuson testified at length in support of his method of converting the estimated future earnings into value. (II 124-176) Basically he assumed earnings to be 13% of value or, expressed as the trustee did, he multiplied estimated earnings by about 7.7 to arrive at value.

Petitioner presented a witness, Dr. Albert B. Morgan, in an attempt to justify the use of projections of earnings based on expectation of continually increasing revenues, untried practices and general economic conditions in

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[20]Testimony explaining this analysis is at II 43-57.

Puerto Rico, and without regard for the trustee's evidence that unfavorable factors were on the horizon. This witness went overboard with estimated future earnings averaging $327,500 after taxes (56% higher than the trustee's) based on speculative assumptions (II 240-249) and he multiplied this estimate by a price-earnings ratio of 13.8 times. (II 250) He obtained this high ratio by averaging those of ten large well established firms that were not comparable to TMT. He came up with a value of $4,519,500 which the court properly refused to consider. His figure is still considerably short of the $5,400,000 in claims that must be satisfied before the stockholders have any equity, and his evidence was fully rebutted by Dr. Heuson, the trustee's witness. (II 300-310)

The court considered all of the evidence and came up with its own finding of going concern value: $2,780,000. (II 387.5-387.6) This finding was based on capitalization at 10% of the estimated 1962 earnings, the highest under the trusteeship.

When the matter was considered again in 1965, further testimony was taken to up-date the 1962 valuation evidence. (II 120-211, 75-83) The new evidence disclosed that 1962 had been the peak year of earnings and that they had fluctuated as follows:

Year	Earnings
1958	$229,000
1959	207,000
1960	210,000
1961	373,000
1962	524,000
1963	403,000
1964	200,000

(II 77)

The record contains a full explanation of numerous unfavorable factors that have contributed to the decline in TMT earnings during recent years.[21] The trustee's general manager had predicted in 1962 that increasing competition was a serious factor (II 907) as was the cost of having to replace some time in the near future the old World War II LST's that the debtor was still using. (II 910) His testimony in 1965 described "rate wars" in Washington before the Federal Maritime Commission which were resulting in rate cutting and reduction in revenue. (III 295-296, 126-140, 79-83)

For example, the rate had to be reduced on automobiles (a major item of traffic for TMT), to meet the competition, from 34¢ to 31¢ per cubic foot, or an average of $14.00 per car. This caused a revenue reduction of $100,000 on the 7,200 automobiles transported in 1964. (III 128) The rate reductions caused the profit per voyage to drop from $5,300 to $2,000 between 1963 and 1964 (III 130-131), while operating expenses increased.

The 1965 findings of insolvency are as follows:

"The Solvency of the Debtor

The court required, by order entered January 5, 1965, further evidence on this subject limited to happenings subsequent to the 1962 valuation hearings. The court had found the debtor insolvent at that time, and it appears from subsequent events that the debtor is more insolvent now than it was in 1962 when earnings had reached a peak. As predicted by the trustee, the level of earnings reached that year of $524,000 did not last. They dropped to $403,000 in 1963 and to $200,000 in 1964. This was caused by several unfavorable factors the principal of which was increased com-

[21]They were $341,000 in 1965 and only $28,000 in 1966, although these figures are not in the record before the court.

petition from large steamship lines serving Puerto Rico. It appears from the evidence that these competitors in the latter part of 1962 began rate-cutting practices deliberately designed to take business from TMT. They have been successful to an extent requiring TMT to reduce its rates on automobiles and other heavy volume traffic, thus materially reducing its margin of profit on each trip. This smaller margin of profit has caused a decline in net earnings in spite of a greater volume of traffic obtained by the increase of the trailership fleet from three to five vessels since 1962. Increases in costs of operation have also contributed to the decline in earnings.

The SEC and the Stockholders Committee, insist, as they did during the valuation hearings in 1962, that the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial changes in operations and acquisition and substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee nor the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances of operation would be speculative and unreliable. The trustee has operated the business successfully for more than seven years and the past earnings recorded under the trusteeship furnish the most reliable basis upon which to measure future earnings for going concern value purposes in this proceeding.

The court in 1962 found the going concern value to be $2,780,000 based upon retention of the high level of earnings during the first half of that year. It is apparent now that this value was too high and would be much lower based on any average of the earnings recorded under the trusteeship.

Another factor which depresses the value of the debtor is the requirement that the government non-

tax claims must be paid in full in cash. This will reduce the equity of the new owners of the debtor by approximately $500,000.

It is therefore the opinion of the court that the debtor remains insolvent, and the court reaffirms its former finding of insolvency and its decision that under the strict priority rule stockholders have no equity in the reorganized company and are entitled to no further participation in these proceedings." (III 266-268)

These findings are fully sustained by the record herein.

b. The district court properly refused to consider speculative estimates of future earnings of the debtor.

Opposing counsel criticise the district court's finding of insolvency based on evidence of the trustee's earnings and insist that the court should have made speculative estimates of what the earnings after reorganization might be *under different operating conditions.*

Petitioner, for example, insisted that since new vessels were required the value of the debtor should include a "projection of the increased net earnings that could be achieved by the purchase of such ships. . . ." (II 1080) However, testimony on behalf of the trustee showed that such an estimate could not be made (III 293-294), that it was not known how much new vessels would cost or how they would be financed and that the trustee considered these to be matters that must be left for determination by the new owners of the company after reorganization. (III 144-151, 294-295)

The SEC argues that the district court refused to consider the *growth* of the debtor's business (brief, p. 53)

but *growth* in terms of increased volume is not the factor involved. The factor is *earnings* which the evidence shows have been declining in spite of increased volume because of cost and competition factors.

The SEC urges that the law "requires recognition of contemplated changes in operations and acquisitions." (brief, p. 54) The law does not require this; it requires contemplation of future *earnings* and those of TMT have been declining. The fact that the district court may have refused to consider future earnings in this case is immaterial because if it had, the going concern value would have been much *less* than the value found of $2,780,000. The SEC position is also unsound because the trustee was not at liberty to "contemplate changes." They would be up to the new owners *after* reorganization.

The arguments of opposing counsel on this point overlook the main issue—that of insolvency. The debtor will not be made more solvent *now* by speculating on possible increased earnings in the distant future under changed conditions of operation and ownership. The new owners must take the risks of necessary expansion and will be entitled to the profits, if any.

c. The cash bids for the assets of the debtor do not indicate a higher going concern value than that found by the district court.

While the brief for the SEC does not mention this point, the Petitioner insists throughout its argument on the valuation question that cash bids exceeding the going concern value found by the court indicated that the court's finding was too low. This argument is entirely misleading because Petitioner neglects to inform the court that these bids were for *all* the assets "including all current

and fixed assets of every kind and nature" (III 750) and *not* assume any of the trustee's liabilities.

The current liabilities were $220,000 on May 31, 1962, (II 348) shortly before the last firm bid of $2,515,000 was received on July 3, 1962 (II 750), prior to the approval by the district court on July 11, 1962, of the two plans under consideration. It was this $2,515,000 bid that was approved and became a part of the Cash Plan that the creditors voted on at the same time they voted on the Internal Plan.

In order to compare the cash offer with the insolvency finding of value, it is necessary to subtract the current liabilities because they would have to be paid out of the cash bid, reducing the net amount available for distribution to creditors to far below the $2,780,000 going concern value as found by the court.

A cash bid of $2,800,000 (II 865-866) was not received until December 17, 1962, long after the creditors had soundly rejected the Cash Plan sent to them for consideration and had overwhelmingly accepted the Internal Plan that gave them ownership of the company. Only 13.5% of the unsecured creditors and 28.4% of the lien claimants had favored the Cash Plan. (II 388)

Petitioner says on page 19 of its brief that this $2,800,000 bid exceeded the court's value of the debtor. This is misleading because it was not a net offer. Petitioner and everyone else involved knew that these cash offers were not attractive to the creditors. They were subject to other infirmities such as the fact that the proposed compromises of the Caplan and Merrill-Stevens claims were *not* included in the Cash Plan (II 373) and its acceptance would have involved extensive litigation over

those claims of uncertain outcome, and the common creditors could have wound up with almost nothing.[22] The Creditors Committee had reported that it would not recommend a cash plan that did not provide for a maximum payment of at least 50¢ on the dollar for the unsecured creditors. (II 652)

Concluding our discussion of the insolvency of the debtor, we point out that the extent of the insolvency is actually much greater than the difference between the $5,400,000 in claims and the $2,780,000 found by the court to be the going concern value. The principal total of the claims must be increased by interest on them before stockholders have any equity. It has been held that the strict priority rule of this court requires that if the debtor in a Chapter X proceeding is *solvent*, creditors must be compensated in full with interest before there is any surplus for stockholders. *In re Inland Gas Corp.*, 241 F.2d 374, 381 (6th Cir. 1957). *Spitzer* v. *Stichman*, 278 F.2d 402, 405 (2d Cir. 1960). The interest on creditors claims since the beginning of these proceedings in 1957 would amount to several million dollars.

It is apparent that this debtor is hopelessly insolvent and that the findings of the district court to that effect are well supported by the evidence.

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[22]The total of all claims superior in class and priority to unsecured creditors totaled more than $2,200,000. (II 288)

5. STOCKHOLDERS ARE NOT ENTITLED TO PARTICIPATE IN THE REORGANIZED COMPANY ON A PARITY WITH COMMON CREDITORS.

The complete findings of the district court on this subject are found in the body of the initial order approving the plan (II 370-382) and are as follows:

> Another proposal, however, was that certain stockholders should be permitted to participate as unsecured creditors upon filing and proving up claims based on rescission of their purchase of the stock. There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from the debtor. No such claims had theretofore been filed and the time for filing claims expired several years ago. The proposal would arbitrarily set aside 25% of the common stock under the Internal Plan for the benefit of stockholders who could prove a right to rescind. The equity of the unsecured creditors cannot be diluted in this manner.
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> The Stockholders' Committee also filed a PROOF OF CLAIM FOR RESCISSION on behalf of unnamed stockholders who purchased stock of the debtor on the open market. The facts stated in this document are insufficient to show that any stockholders as a class or individually have valid claims against the debtor. Furthermore, the claim is filed too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage.
>
> Likewise, the claim filed by Irma S. Mason, wife of a member of the Stockholders' Committee, seeking to rescind her purchases of TMT stock on the open mar-

ket is without merit for the same reasons. It shows that her damages, if any, are recoverable against others than the debtor. (II 379-380)

The equity and correctness in the finding of the district court are reflected by the affirmance of the court of appeal:

> No valid reason or excuse is given for the delay from July 1960 until June 1962. To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to litigate and which might have delayed indefinitely the formulation of any plan of reorganization would have been extremely prejudicial to the creditors. (364 F.2d at p. 940)

a. The alleged stockholders' claims were not timely filed.

The briefs of the Petitioner and the SEC proceed to a discussion of the errors of the lower courts on an invalid assumption, i.e., that the alleged rescission claims do, in fact, exist. The Petitioner gives the impression that a large body of dissident stockholders have been prohibited from presenting their claims via the Petitioner by the actions of the district court. After all these years, the committee representing stockholders has been able to get only one stockholder to file a claim for rescission, Irma S. Mason, who is *one of the attorneys of record for Petitioner!* The actions of Petitioner in waiting until June, 1962, to file a rescission claim can only be explained by a decision to elect the status of a shareholder after it became apparent that the debtor was insolvent and that stockholders were to be excluded from participation in the reorganized company. Such dilatory action has contributed to unnecessary delay in the consummation of the plan of reorganization.

The Petitioner would give the impression that their rescission claims were not timely presented due to a lack of

knowledge of the facts upon which they were grounded and that when such facts were known they were prohibited from pressing such claims. This position is not sustained by the record. Petitioner knew of some of the facts underlying the claim for rescission as early as 1958 but elected not to pursue that course of action until 1962.[23]

Petitioner argues that its Petition for Leave to File a Statement of Position filed in April, 1963, was tendered to the court in March, 1961, but the court would not accept it at that time.[24] The record reveals nothing to substantiate the alleged tender of any statement of position concerning rescission claims by the protective committee. An order was entered on April 26, 1961, denying a petition by Petitioner for leave to file a statement of position. The order does not indicate the nature of the petition. (II 861). The petition referred to was not filed until April 16, 1963 (II 962), is dated March 21, 1961, and clearly states that the statement of position which is desired to be filed pertains ". . . to certain matters referred by the Court to the Special Master and generally with respect to the validity and status of the claims of Arthur Shaffer and M. James Spitzer as trustees of a certain alleged mortgage, and of the beneficiaries of said alleged mortgage and with respect to the claims of Merrill-Stevens Drydock & Repair Company, and of certain other claimants."

There was nothing in the petition to indicate that it pertained to rescission claims. The only things that had been referred to the Special Master were the mortgage and the lien claims against the vessels of the debtor. It is true that the record shows the filing on April 15, 1963, of a

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[23]See letter dated November 10, 1958, from Petitioner's counsel to the district judge. (I 128-134)

[24]Petitioner's Brief p. 14, footnote 17.

Statement of Position by Petitioner (II 1037) which is *dated* March 21, 1961, and which makes general reference to the possibility of rescission claims. (II 1039) But there is nothing to indicate that the issue was ever brought to the attention of the court or any interested party in March of 1961 as Petitioner contends. In any event the matter lay dormant in the bosom of Petitioner until a year later and no explanation is furnished for the failure to file any stockholder's rescission claim as soon as its existence was known.

This Statement of Position, dated March 21, 1961, and filed April 15, 1963, expressly recognizes that the bar date of April 14, 1958, for filing claims had long passed when in paragraph 9 a request was made to extend the time for filing claims. (II 1039)

The alleged rescission claims (II 358-368) were not filed until about June 19, 1962, which was *after* all the hearings had been held to consider the two plans of reorganization and only three weeks before the court entered its order approving the plans and refusing to consider the alleged rescission claims. (II 370-382) The first appearance on the record of anything pertaining to rescission claims was in a pleading filed by Petitioner on March 20, 1962. (II 1074) We submit that no valid reason for the delay is shown.

The committee now urges, however, that "It would be absurd to compel the committee to comply at this stage with the formal requisite of a proof of claim that it identify each stockholder by name, address and certificate number for the purposes of a securities law claim any more than for a claim to a piece of the equity."[25] This statement is confusing in view of the Petitioner's request to remove the 1958 bar date and considering the practical necessity under its

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[25]Petitioner's Brief, p. 58.

own theory of rescission for individual stockholders to make of record the circumstances under which they purchased their stocks, and the price paid, etc.

Under subpoint 2 of its Point III on appeal, Petitioner claims it was error for the court to determine in the absence of a hearing that the alleged stockholders' claims were filed too late. We submit, however, that the records before the court below showed the appearances of Petitioner from 1958 until its proof of claim in 1962, and that at no time did it, prior to the spring of 1962, urge the rescission claims upon the court, nor was any excuse offered for the delay in raising the issue until 1962. In fact, when in the spring of 1962 Petitioner finally filed its suggestions which first set forth the rescission theory, it evidenced its indecision to elect to pursue either the posture of creditor or shareholder by stating, "the entire consideration of independent stockholders' rescission claims will of course become unnecessary if an adequate equity for them is otherwise recognized." (II 1086) It is on this record of equivocation by Petitioner that the district judge determined that the time had passed to file a tort claim for rescission.

To use a trite but appropriate phrase, Petitioner is attempting to have its cake and eat it too. It cannot maintain the posture of a stockholder and then shift when the position suits to the posture of a defrauded creditor. Such action makes a mockery of the need for a bar date designed to bring an end to the filing of claims. The record before the court and the circumstances pointed out above were clearly sufficient to sustain the dismissal of the alleged rescission claims without a hearing.

b. The alleged stockholders' claims are factually insufficient to warrant their consideration.

The stockholders' alleged claims are claims for rescission and absent the citation of SEC Rule 10(b)(5) and the various quotations from cases thereunder in the SEC brief, a short answer to the issue would be that the defrauded buyer's right to rescind his purchase exists only as against the person who sold the securities to him. This obvious proposition follows from the inherent nature of the rescission remedy, i.e., the restoration of the party to the *status quo* which existed prior to the fraud. The proofs of claim filed herein (II 358-368) seek to rescind open market purchases of TMT shares as against the debtor which never received directly or indirectly the consideration paid on the open market, and which itself was defrauded in parting with those shares through the wrongdoing of the true culprits. The stockholders' claims for rescission as against TMT are illogical on their face and the question arises whether Rule 10(b)(5) incorporates this lack of logic in the law of interstate securities frauds. No one doubts that Rule 10(b)(5) has relaxed the old common law standards of privity or that the common law itself has recently relaxed those standards, but the consequences of this relaxation do not include the results now urged here.

This relaxation of the necessity for privity is intended only to enable the injured person to reach the guilty beneficiary for recovery of his damages. TMT received *no benefit* from money paid on the open market by purchasers of its shares. The rule of law recognizing the right of a defrauded buyer to recover his purchase price has been stated in 78 C.J.S., Sales, Sec. 490, as follows:

> The right of a buyer to recover sums paid under a rescinded contract does not rest on agreement but rather is grounded on the theory that the seller, having

> obtained money under a contract made void by rescission is unjustly enriched at the buyer's expense and as a consequence should be subjected to a legal duty to restore that which has been improperly gained.
> *Kavli* v. *Leifman*, 292 N.W. 210, 207 Minn. 549.

TMT has not been enriched by the alleged fraud perpetrated on the open market buyers of its stock. Therefore, recovery against it in a rescission action cannot be had. TMT has itself been the victim of the alleged fraudulent transfers of its stock by various persons.

We agree with the part of the SEC argument on pages 64-65 of its brief that privity is not required for rescission recovery by a defrauded stock purchaser.

However the relaxation of privity is designed to prevent the escape from liability of any party to a fraudulent scheme, no matter how he had technically insulated himself from the ultimate fraudulent transaction with the innocent buyer, not to create causes of action against persons who themselves were duped by the fraudulent scheme. None of the persons named in the two alleged rescission claims (II 358-368) as having improperly acquired TMT stock which they dumped on the market were officers or directors of TMT.

c. If rescission claims were allowed, they would necessarily be subordinate to the claims of creditors.

Regardless of the merits of alleged stockholder claims against TMT, the fact remains that *innocent creditors* entered relationship with TMT on the basis of its alleged over-stated balance sheets with the expectation of being able to recover fully out of its assets before any distributions were made to shareholders, and the shareholders entered into their relationships by buying on the open market

with the realization that if insolvency should occur and if TMT assets should prove to be worth less than the amount at which they were carried on the balance sheet, the creditors whose claims were reflected on the balance sheet as liabilities would be entitled to a senior position in reorganization. These expectations and these consequences are basic to the functioning of our industrial and financial economy and every consideration of prudence and fairness dictates that the expected rights, preferences and disabilities of the parties be adhered to in reorganization proceedings.

Rescission claims by stockholders traditionally have been subordinate to creditors' claims in bankruptcy proceedings:

> The law of the domicile of this bankrupt corporation in which appellant is a stockholder, and the great weight of authority, are that, given a corporation insolvent and unpaid subscriptions, corporate fraud inducing the subscriptions affords no stockholder a defense to collection, or ground for rescission, or basis for trust or lien, to the prejudice of corporate creditors. A fortiori, nor in respect to stock subscriptions paid. (Citing other cases)
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> However ignorant appellant of corporate insolvency and transactions, he knew the corporation was engaged in business, and might, as it did, incur debts. Hence he was charged with notice and knowledge of corporate status and acts, so far as creditors were concerned. That no creditors knew he was a stockholder is immaterial. Credit is given to corporations, with little or no knowledge of names of stockholders, but with confidence that, whoever they are, their rights in and to corporate property are subordinate to the rights of creditors.
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> *In re Irving Whitehouse Co.*, 293 Fed. 287 (9th Cir. 1923)

Petitioner attempts to set aside this traditional bankruptcy principle by an appeal to the principles in *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206, a case arising under the National Bank Act. (12 U.S.C., Sec. 21 et seq.) A review of the National Bank Act clearly distinguishes it from the Bankruptcy Act. The Bank Act provides "the comptroller (of currency) shall make a ratable dividend of the money so paid over to him by (a) receiver on all such claims as may have been provided to his satisfaction or adjudication in a court of competent jurisdiction." (12 U.S.C., Sec. 194) Distribution is not entrusted to a court of equity empowered to determine the order of distribution, but to an administrative official bound by a statute which directs ratable distribution on *all claims*. The unique nature of national bank proceedings was noted by this court in *Cook County National Bank* v. *United States*, 107 U.S. 445, where it was faced with the question as to whether the United States' statutory priority of payments for debts due to it applied in a case of an insolvent national bank. The court stated that:

> . . . the act authorizing the formation of national banks . . . constituting by itself a complete system for the establishment and government of national banks. . . . Everything essential to the formation of the banks, the issue, security, and redemption of their notes, the winding up of the institutions, and the distribution of their effects, are fully provided for, as in a separate code by itself, *neither limited nor enlarged by other statutory provisions with respect to the settlement of demands against insolvents or their estates.* (107 U.S. at 448) (Emphasis supplied)

This court held that R.S. 5236 (12 U.S.C., Sec. 194) "provides for the distribution of the entire assets of the bank, *giving no preference to any claim* except to monies to reimburse the United States for advances in redeeming notes." (*Id.* at 450) (Emphasis supplied)

The proposition propounded by the *Cook County National Bank* case that the statutes with respect to national banks require ratable distribution without regard to other statutory priorities or other equities has been consistently adhered to.

In *Texas & Pacific Railway Co.* v. *Pottorff,* 291 U.S. 245, 255, Justice Brandeis stated in the course of considering whether national banks had power to pledge their assets to secure a private deposit, that to permit such pledge "would be inconsistent with many provisions of the National Bank Act which are designed to insure, in the case of disaster, uniformity in the treatment of depositors and a ratable distribution of assets."

Other than cases controlled by the National Bank Act, it is uniformly held that stockholder rescission claims, even when a corporate fraud exists, are subordinate to the rights of creditors. In cases involving insolvent state banks (the rigidity of the National Bank Act being inapplicable), stockholders who have been induced to purchase stock by false representations are subordinate to the rights of depositors and other innocent general creditors. See, e.g., *Green* v. *Stone,* 205 Ala. 381, 87 So. 862 (1921); *Davis* v. *Burns,* 173 S.W. 476 (C. App. Tex. 1915); *Burleson* v. *Davis,* 141 S.W. 559 (C. App. Tex. 1911).

The SEC brief states "under both statutes (Bankruptcy Act and National Bank Act) the ultimate standard is one of an equitable distribution of assets." A review of the equities in this cause indicates that they lie with the Respondent and the creditors and not with the Petitioner and the stockholders.

It is inequitable to allow parity treatment of stockholders' rescission claims because the claimants bargained for equity-type profits and assumed equity-type risks. In

contrast, orthodox creditors dealt with the corporation with the expectation that they would have a senior position as against its assets to that of stockholders. They bargained for debt-type profits and certainty of payment.

This basic difference exists even where a corporate management has been guilty of the grossest fraud. When (as here) both creditors and stock purchasers have been defrauded, the equities obviously favor the former over the latter. A defrauded stock purchaser always has an option to ratify his purchase and thus is able to straddle the future prospects of the manipulated company. If things go well, he shall be a stockholder, and if things go poorly, he shall be a creditor. This straddle is inequitable at least vis-a-vis unsatisfied creditors.

The history of the Stockholders Committee in this proceeding shows the most flagrant straddling. Initially it claimed that the debtor might be solvent but at least as early as July 1, 1960, when the Report of Investigation was filed, it had knowledge that the market had been flooded with stock that should not have been resold. Thereafter, for nearly 2 years the Committee failed to file a single rescission claim, nor did any stockholder other than Mrs. Mason who, of course, is estopped to assert the timeliness of her claim because she is of counsel here. The SEC brief on page 69 suggests that the court at this late date should fix a time for the filing of claims by stockholders. But there is nothing to indicate that any would take advantage of the invitation.

d. The rescission claim on behalf of all "non-management" stockholders cannot be recognized as a class claim.

Counsel for Petitioner filed this claim based on allegations "made on information and belief". (II 363-368) It as-

serts that all "non-management stockholders" have "a right to rescind the purchase" of TMT stock made by them on the open market.

The claim of each such stockholder would be in *tort* and would be unliquidated as to amount. Each would depend on the time and circumstances of purchase, the consideration paid and lost on the transaction, and whether the stock could be traced as having come into the claimant's hands wrongfully. This is not the kind of class action permitted by Rule 23 of the Federal Rules of Civil Procedure. *Speed* v. *Transamerica Corporation*, 5 F.R.D. 56 (D.C. Del. 1945); *Joseph* v. *Farnsworth Radio and Television Corporation*, 99 F. Supp. 701 (S.D. N.Y. 1951); *Gilbert* v. *Clark*, 13 F.R.D. 498 (D. Mass. 1952); *Farmers Co-op Co.* v. *Socony Vacuum Oil Co.*, 133 F.2d 101 (8th Cir. 1942).

Nor can we find any provision in the Bankruptcy Act for the filing of a class claim on behalf of unknown tort claimants in unknown, unliquidated amounts. Section 209 authorizes any creditor or stockholder to be represented by a committee but this does not permit class claims for unknowns. Section 210 requires the filing of the names and addresses of all creditors or stockholders represented by an attorney together with the nature and *amount* claimed. Section 211(4) requires a statement under oath showing the amounts of claims represented by a committee.

Petitioner has been approved by the district court as a stockholders committee but has neither sought nor obtained approval to represent stockholders as *creditors*.

We submit that there is no basis for giving any recognition or effect to this class claim and that it was properly refused consideration by the district court.

6. THE DISCHARGE OF THE STOCKHOLDERS COMMITTEE WAS PROPER.

Chapter X of the Bankruptcy Act clearly contemplates that, upon confirmation, a plan of reorganization shall be binding upon all parties and interests, including stockholders (Section 224 (1)), and that any class which does not participate under the plan should likewise not participate in further proceedings. Section 247 was amended in 1962 to make it very clear that upon confirmation of a plan from which no appeal is pending such classes need not even be given notice of hearings on applications for allowances. As explained in House Report No. 1208, 87th Cong. 1st Sess. (1961), "Once a plan has been confirmed, eliminating participation on the part of any class of creditors or stockholders, notice as to applications for allowances is purely academic and, in the interests of economy, should be eliminated. The typical situation, of course, is one in which a corporation is found to be insolvent and no provision for stockholder participation is contained in the confirmed plan."

The Stockholders Committee was discharged primarily because it had been determined that the debtor was insolvent and the services of the Stockholders Committee were no longer useful. (III 387-389) The rights of the stockholders have not been prejudiced because a modifying order was entered authorizing the Stockholders Committee to prosecute its appeals from the orders of the district court. (III 411-412)

CONCLUSION

All of the issues involved require an evaluation of the facts and circumstances connected with the affairs of this debtor. No good reason has been shown for sending this case back for further consideration of the facts in view of the thorough hearings held in the district court prior to the 1962 and 1965 orders approving the plan. There is no indication that further review would result in any different result. The plan of reorganization is basically fair and equitable to the creditors who desire to retain the services of the trustee, who have accepted the compromises of the disputed claims and who are entitled to full priority over stockholders since the debtor is insolvent.

The purpose of Chapter X of the Bankruptcy Act is to look to the future of the debtor and not to the past. The debtor should not be burdened with the expense and delay of trying to punish all who may have caused the decline and fall of TMT where the crusade might be fruitless and there is urgent need for the termination of the trusteeship.

TMT is being seriously harmed by the long delay caused by the efforts to block the reorganization desired by the real parties in interest who are the creditors. The old World War II LSTs which are the life blood of the company were built to be expendable and are inefficient. The major financing required to replace them cannot be had while the trusteeship exists; the Department of Commerce has approved as feasible the guaranty of a large loan for this purpose, but will not consider it as long as the plan of reorganization is under attack in the courts.

It is necessary, as the district court and the court of appeals observed, for the reorganization proceedings to be concluded without further delay; otherwise the company

may not survive and the fruits of a successful trusteeship benefit no one.

We respectfully submit that the orders and opinions of the lower courts should be affirmed.

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